

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 97-0339**

**Individual Income Tax**

**Calendar Years 1993, 1994, 1995**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUE(S)**

**I. Adjusted Gross Income – Disallowance of Enterprise Zone Credits**

**Authority: IC 6-3-3-10; Information Bulletin No. 59**

Taxpayer protests the disallowance of the Enterprise Zone Credits.

**STATEMENT OF FACTS**

Taxpayer is a shareholder in Company X, a Subchapter S Corporation located in an Elkhart, Indiana enterprise zone. From 1993 through 1995, the enterprise zone credit was claimed by the corporation, passed through to the shareholders, and claimed on the individual income tax returns.

The corporation was audited by the Indiana Department of Revenue, which resulted in no change to the corporate returns. Based upon instructions found in the IT-20S Instruction Booklet, however, the auditor has disallowed the referenced credit to the shareholders. The taxpayers believe that based upon Indiana Law and the resolution of a previous protest filed by company X with the Indiana Department of Revenue the credit should be allowed.

**I. Adjusted Gross Income – Disallowance of Enterprise Zone Credits**

**DISCUSSION**

Taxpayer protests the disallowance of the Enterprise Zone Credits.

Taxpayer's Arguments are as follows:

Taxpayer states that IC 6-3-3-10 allows a taxpayer a credit against its qualified state tax liability for a taxable year. Qualified state tax liability is then further defined in this section of the code as meaning a taxpayer's total income tax liability incurred under:

- 1) the gross income tax code section (IC 6-2.1);
- 2) the adjusted gross income tax section (IC 6-3-2 to IC 6-3-8);
- 3) the insurance premiums tax section (IC 27-1-18-2); or
- 4) the financial institutions tax section (IC 6-5.5).

While S Corporations are not subject to either of the listed taxes, the AGI code referenced above includes adjusted gross income tax paid by individuals. In addition, Code section 6-3-3-10 dealing with the credit does not define taxpayer. Further, there is NO exclusion listed for S corporations. The section dealing with the Enterprise Zone Loan Interest credit, however, does define taxpayer. In this section, "taxpayer" means any person, corporation, limited liability company, partnership, or other entity that has any state tax liability. It is reasonable then, that since no definition is included for "taxpayer" in the discussion for one type of enterprise zone credit, the definition found under the other type of enterprise zone credit is applicable.

Taxpayer further references Information Bulletin #59 which provides information regarding the application of tax credits available to taxpayers. This bulletin states that in the case of S Corporation returns, most credits are allocated to their respective shareholders. Nowhere in this bulletin, or in the code, do we find any reference to which credits do or do not pass through to the shareholders. It seems reasonable to assume that if a particular credit does not pass through, the code section providing for credits would so state. As previously mentioned, IC 6-3-3-10 does not address this.

In 1991 Company X was assessed tax, interest, and penalty for not withholding non-resident shareholder withholding for the 1988 tax year. Company X protested this assessment to the audit division. The argument in the protest was that the corporation was entitled to an Enterprise Zone Employment Expense Credit, which was passed through to the shareholders, and more than offset the tax. The result of the protest was that the Department of Revenue accepted the explanation provided and waived the additional tax assessment. In effect, the previous ruling can be interpreted as the Department of Revenue approving the pass through of enterprise zone credit to S Corporation shareholders.

Based upon these facts, while the S Corporation tax return form instructions state that the enterprise zone credit cannot be taken by an S corporation, we find no support for this in the law. Since the law does not exclude S corporations from the credit, it would appear that the individual shareholders should fall within the guidelines for taking the credit. In addition, since there was a prior ruling by Indiana which allowed company X to take this credit, it was reasonable for Company X to continue to take the credit on its returns for the referenced years, pass through those credits to the shareholders, and the credits to

be claimed on the individual return.

The Department, however, finds that according to IC 6-3-3-10, a taxpayer is entitled to a credit against the taxpayer's "qualified state tax liability". Because the taxpayer is an S Corporation, by definition they have no state tax liability. In addition, the S Corporation tax return booklet, for each year of the audit, clearly states that enterprise zone credits do not pass through to shareholders.

Taxpayer states it had a previous ruling which can be interpreted as the Department approving the pass through of the enterprise zone credit to S Corporation shareholders. The Department issued no ruling but erroneously cancelled the 1988 liability, which pertains to withholding tax.

The department waived its negligence penalty as the taxpayer reasonably believed its filing to be correct after the department erroneously cancelled the 1988 liability to the corporation.

### **FINDING**

Taxpayer's protest is denied.